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JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1958

No. 624

EUGENE J. ARNFELD and HENRY J. MOSES, Executors of the Estate of ANDREW WINEMAN, Deceased, and EUGENE J. ARNFELD and MORTIMER H. MEYER, Successor Executors of the Estate of ELSA WINEMAN, Deceased, *Petitioners*,

v.

THE UNITED STATES OF AMERICA, *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

J. MARVIN HAYNES
Attorney for Petitioners
928 Investment Building
Washington 5, D. C.

HAYNES & MILLER
N. BARR MILLER
JOSEPH H. SHEPPARD
ARTHUR H. ADAMS
Of Counsel

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THE UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

The petitioners, Eugene J. Arnfeld, et al., pray that a writ of certiorari issue to review the judgment of the Court of Claims in the above-entitled case.

OPINION BELOW

The opinion of the Court of Claims is not yet officially reported but is set forth in Appendix I, *infra*, pp. 1a-16a.

JURISDICTION

The judgment of the Court of Claims was entered on July 16, 1958. On October 8, 1958, that court overruled the petitioners' timely motion for rehearing. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTION PRESENTED

Did the taxpayer realize capital gain or ordinary income from the *bona fide* sale of an annuity policy held for more than six months, the sale having occurred before the maturity date of the annuity and before there accrued to the seller any ordinary income under the terms of the policy?

STATUTES AND REGULATIONS INVOLVED

The statutory provisions involved are Sections 117(a)(1), (a)(4) and (b) of the Internal Revenue Code of 1939, and the Regulations involved are Treasury Regulations 111, Sec. 29.117-1, all of which are set forth in Appendix II, *infra*, pp. 18a-19a.

STATEMENT

The petitioners are the duly qualified executors of the Estate of Elsa Wineman and her husband Andrew Wineman (R. 28).

On January 6, 1933, Andrew Wineman purchased a variable deposit annuity policy, making an initial deposit of $10,000 (R. 28). Five days later he assigned the policy to his wife, Elsa (R. 28). The policy was due to mature on January 6, 1951, when Andrew Wineman would become 70 years of age (R. 28). Elsa Wineman made additional deposits of $71,000

during her ownership of the policy (R. 31). On January 3, 1951, prior to its maturity, Elsa sold the policy to an unrelated third party (R. 30). The court below specifically found that the sale was *bona fide* (R. 23, 24, 31). The agreed selling price was $117,000 (R. 29) and Elsa realized a gain of $36,000 over her cost (R. 32). The buyer (who is not a party in this proceeding) elected to surrender the policy, and on January 15, 1951, after the maturity date of the policy, he received from the issuing insurance company the sum of $117,330.14 (R. 30-31). After deducting his costs the buyer reported his net profit on the transaction as ordinary taxable income (R. 31).

The Winemans filed a joint Federal income tax return for 1951, in which they reported the $36,000 as a long term capital gain from the sale of a capital asset (R. 31-32). The Commissioner of Internal Revenue determined that the gain was ordinary income (R. 32) and the court below sustained that determination.

REASONS FOR GRANTING THE WRIT

Certiorari is requested on the following grounds:

1. The Decision Below is in Conflict With Decisions of This Court, the Courts of Appeal, and the Tax Court.

The holding of the lower court that the gain realized by Elsa Wineman from the sale of her entire interest in an annuity policy was not a capital gain, because it "would in time constitute ordinary income," (Appendix I, p. 9a) is in conflict with the holding of this Court in *Blair* v. *Commissioner*, 300 U.S. 5 (1937); and is also in direct conflict with the holding of the Courts of Appeal for the Second and Eighth Circuits

in *McAllister* v. *Commissioner*, 157 F. 2d 235 (1946), cert. den. 330 U.S. 826 (1947), and *Bell's Estate* v. *Commissioner*, 137 F. 2d 454 (1943), respectively.

The decision below is also in direct conflict with the recent decision of the Tax Court of the United States in the case of *Percy W. Phillips*, 30 T.C., No. 87 (decision entered on September 23, 1958). In that case, on facts indistinguishable from those here, the Tax Court concluded that the gain realized from the *bona fide* sale of a similar policy resulted in capital gain. That case was appealed to the Court of Appeals for the Fourth Circuit on December 22, 1958, and if affirmed, there will exist a direct conflict between the Court of Claims and a Court of Appeals on the tax consequences of the sale of annuity and endowment insurance policies which this Court ought to settle definitely.

In *Blair* v. *Commissioner*, *supra*, this Court held that a taxpayer's irrevocable assignment to his children of $9,000 per year interests in a life estate of which he was the life beneficiary was not an anticipatory assignment of income and that the assignees rather than the taxpayer were the proper persons to whom the Government should look to collect the tax on such amounts of income. This Court reasoned that the yearly income payments which the children received arose from their ownership of a part of the taxpayer's equitable interest in the life estate because after the assignment, the taxpayer had no further interest in or control over that part of the estate which had been given to them. This Court said the right to the income there in question was so identified with the ownership of the property produc-

ing it, that a gift of the income was impossible without a gift of the property.

Applying that principle to the case at bar, it was the buyer and not the seller of the annuity policy who realized ordinary income when the annuity policy matured *after the sale.* As in *Blair,* when Elsa Wineman sold the policy she divested herself of the entire property which would produce the future income, and had no ownership interest whatever when that future income was realized by the purchaser. Cf. *Helvering* v. *Horst,* 311 U. S. 112, where there was no transfer of the income producing property, but only of the right to income realized later in the same taxable year. On the date of sale of the whole property interest in the annuity, Elsa Wineman was entitled to nothing from the insurance company which issued the policy because the maturity date had not yet arrived. That is precisely what this Court held with respect to the taxpayer in the *Blair* case. He had parted with the property before the income therefrom had been realized, and he was therefore not taxable on such income when later received by the transferees.

Moreover, in the present case, even at the maturity date, had Elsa still been the owner, she could have elected to receive a life income instead of surrendering the policy for redemption. In this latter event, Elsa would have realized taxable income only in the future years as she received the annuity payments. Section 22(b)(2) of the 1939 Internal Revenue Code. And the judicial authorities are in agreement that if she had sold her property interest in the annuity after having elected the life income option, any gain realized by her would have been capital gain. See *McAllister* v. *Commissioner, supra,* and *Bell's Estate* v. *Commissioner, supra,* the Courts of Appeal for the Second and

Eighth Circuits held that the gain arising from the sale of an entire interest in a life estate was a capital gain rather than ordinary income.

The controlling facts of the instant case are indistinguishable from those in *Blair*, *McAllister* and *Bell's Estate*. In those cases the taxpayers sold or assigned their full property interest in an income-producing asset. In both *McAllister* and *Bell's Estate* the sale price undoubtedly was determined in part by the discounted value of the future earnings which ownership of the assets would produce.

Here, also, Elsa Wineman sold her full and complete interest in the annuity policy. A part of the price which she received represented the discounted value of the future income which the policy would have produced had she held it to maturity and thereafter received periodic income payments. In both *McAllister* and *Bell's Estate*, the fact that the taxpayers forever disposed of all of their interest in the income-producing property was thought to be controlling and hence resulted in the gain being taxed as capital gain.

Despite the indistinguishable pattern of the facts there and here, the court below held that Elsa Wineman could not, by selling the asset itself before the right to the income had accrued, "convert what would in time constitute ordinary income under section 22(b) into capital gain." The court below did not dispute the fact that the annuity policy was a capital asset and specifically held that Elsa Wineman had irrevocably parted with all of her right, title and interest to the policy in a *bona fide* sale. In the face of those facts it is obvious that the

court below ought to have but failed to apply the rule established by this Court in *Blair* v. *Commissioner, supra,* to the instant case. In alluding to *Commissioner* v. *P. G. Lake, Inc.,* 356 U. S. 260 (1958), as authority for its conclusion, the court below failed to observe the fundamental distinction between *Blair* where there was a complete and irrevocable disposition of income-producing property and *Lake* where there was only a three year assignment of part of the income from oil property. This Court emphasized this distinction in *Harrison* v. *Schaffner,* 312 U. S. 579, at pp. 582-583:

> "... We think that the gift by a beneficiary of a trust of some part of the income derived from the trust property for the period of a day, a month, or a year involves no such substantial disposition of the trust property as to camouflage the reality that he is enjoying the benefit of the income from the trust of which he continues to be the beneficiary, ..."

Here there was no temporary disposition "of some part of the income derived from the ... property for the period of a day, a month, or a year" as there was in *Lake.* Elsa Wineman sold her complete interest in an income-producing capital asset prior to the time the right to income therefrom accrued. The principles established by this Court in *Blair* require the gain on such sale to be taxed as a capital gain.

Underlying the decision of the court below is the erroneous notion that a taxpayer cannot avoid the tax on future income by disposing of the income-producing property before right to such income has accrued. This idea is directly contrary to long-established and thoroughly sound principles embedded in

our tax laws as the *Blair* case illustrates. Similarly, under the Code itself, if a capital asset is sold five months and 29 days after acquisition, any gain realized will be ordinary income, but if held for six months and one day the same gain will be taxed as capital gain. Section 117 of the 1939 Code and Section 1201 et seq. of 1954 Code. Likewise, the courts, including this Court, have always been careful to protect the right of a taxpayer to take any *bona fide* action he chooses to reduce his taxes so long as he observes the provisions of the tax laws. In *Gregory* v. *Helvering*, 293 U.S. 465, this Court said (p. 469):

> "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

The court below expressly recognized this principle, citing the *Gregory* case. Appendix I, p. 7a. However, it wholly failed to apply such principle to the case before it. Instead of giving effect to the tax consequences of the sale of the policy, the court approved the imposition of the tax just as though no sale had been effected and Elsa Wineman had continued to own the policy to maturity. Thus, the court's decision ignores the actual transaction and imposes the tax on "what would in time constitute ordinary income."

2. The Decision Below Raises an Important Question in the Administration of the Tax Laws Which Has Not Been But Should be Decided by This Court.

Until the decision of the court below, it had long been recognized that the present commuted value of expected future earnings from a capital asset, which

had neither accrued nor were otherwise payable, was taxable as a long term capital gain when realized by a cash basis taxpayer upon the *bona fide* sale of his entire interest in such asset. For the first time, a lower court taxes as ordinary income the gain presently realized by a cash basis taxpayer from the *bona fide* sale of a capital asset because the asset would someday produce an equivalent or greater gain which would be so taxable under Section 22(b)(2) if received in future years in periodic payments. The fact that the Tax Court in the *Phillips* case reached precisely the opposite conclusion emphasizes the pressing importance of this question and demonstrates the uncertainty and confusion created by the decision below to the Treasury in the administration of the tax laws and to the many owners of annuity and insurance policies.

The importance of the immediate question raised herein is further emphasized by the fact that the holding of the lower court has implications far beyond the factual limits of the present proceeding. Its decision can apply not only to annuity policies but if permitted to stand must logically be extended to all income producing capital assets. Hence, when any capital asset is sold for a price which may include the present commuted value of future anticipated income, the gain would be taxable as ordinary income rather than as long term capital gain. If permitted to stand, that holding can only create confusion and uncertainty in an area of great importance in the administration of the revenue laws.

Alternative Request That Petition be Held in Abeyance Pending Decision of the Fourth Circuit in the Phillips Case.

As heretofore stated, the Government has appealed the decision of the Tax Court in the case of *Percy W. Phillips, supra,* on precisely the same issue. An affirmance of the decision of the Tax Court by the Fourth Circuit will create a direct conflict with the decision below in the instant case. This Court should grant certiorari now because the question is an important one on which an actual conflict exists and a petition in the instant case after affirmance in *Phillips* would be untimely and contrary to the rules of this Court, Rules 38 and 58(4).

In the alternative, and in the event this Court is not disposed to grant certiorari at this time, it is suggested that this petition be held in abeyance pending the decision by the Court of Appeals in the *Phillips* case.

CONCLUSION

The petitioners respectfully request this Court to grant their petition for certiorari and reverse the decision of the court below, or, in the alternative, to hold in abeyance this petition pending the decision by the Court of Appeals in the *Phillips* case.

Respectfully submitted,

J. MARVIN HAYNES
Attorney for Petitioners
928 Investment Building
Washington 5, D. C.

HAYNES & MILLER
N. BARR MILLER
JOSEPH H. SHEPPARD
ARTHUR H. ADAMS
Of Counsel